CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 12, 2000

S. 2420
Long-Term Care Security Act
and
Federal Erroneous Retirement Coverage Corrections Act

As ordered reported by the Senate Committee on Governmental Affairs on June 14, 2000

SUMMARY

S. 2420 has two major components. Title I of the bill, the Long-Term Care Security Act, would require the Office of Personnel Management (OPM) to develop and administer a long-term care insurance program for federal employees, members of the uniformed services, retirees from federal or military service, and specified relatives of the primary eligible groups. Because the federal government would not contribute to the enrollees' premiums, and the insurer or insurers would be required to reimburse OPM for its expenses in setting up and administering the plan, net federal outlays would be zero over the long run. However, the government would initially incur some start-up costs, which would ultimately be reimbursed by the insurers.

Title II, the Federal Erroneous Retirement Coverage Corrections Act, would alter the procedures for correcting situations where federal employees have been mistakenly placed in the wrong retirement system. Many of those retirement coverage errors occurred between 1984, when the Civil Service Retirement System (CSRS) was closed to new entrants, and 1987, when the Federal Employees' Retirement System (FERS) was created.

CBO estimates that this bill would reduce discretionary spending by $51 million over the 2001-2005 period, primarily because of lower agency contributions to the Civil Service Retirement and Disability Fund (CSRDF) and the Thrift Savings Plan (TSP). S. 2420 would also increase direct spending by $20 million over the same period. Because the bill would affect direct spending, pay-as-you-go procedures would apply.

The bill would preempt state laws governing long-term care contracts for federal employees, and this preemption would be an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). Also, the requirements to continue retirement coverage in

some instances and to correct retirement errors in others for employees of the District of Columbia and Gallaudet University would be intergovernmental and private-sector mandates. However, CBO estimates that the cost of those mandates would be small and would not exceed the thresholds established in UMRA ($55 million for intergovernmental mandates and $109 million for private-sector mandates in 2000, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 2420 is shown in the following table.

	Outlays by Fiscal Year, in Millions of Dollars				
	2001	2002	2003	2004	2005
SPENDING SUBJECT TO APPROPRIATION					
Title II					
Makeup Contributions to TSP	- a	15	- 3	- 4	- 4
Makeup Payments to Social Security	- a	a	0	0	0
Makeup Payments to the CSRDF	- 3	2	- 3	- 4	- 4
Agency Retirement Contributions	- a	- 2	- 5	- 6	- 6
Employer TSP Contributions	- 1	- 4	- 7	- 7	- 8
Employer Social Security Contributions	- a	- a	0	0	0
Total - Subject to Appropriation	- 4	13	- 18	- 20	- 22
CHANGES IN DIRECT SPENDING					
Title I					
OPM Administrative Expenses	3	18	- 21	0	0
Title II					
OPM Administrative Expenses	1	1	a	a	a
Federal Retirement Benefits	a	2	a	a	a
Transfers from CSRDF to Social Security Trust Funds	- 3	3	0	0	0
Postal Service Contributions to the CSRDF	1	- a	4	5	5
Postal Service Outlays (off-budget)	- 2	6	- 4	0	0
Postal Service Contributions to Social Security Trust Funds (off-budget)	a	- a	0	0	0
Receipt of Transfers by Social Security Trust Funds (off-budget)	3	- 3	0	0	0
Subtotal - Title II	1	9	a	5	5
Total - On-Budget Direct Spending	3	23	-16	5	5
Total - Off-Budget Direct Spending	1	3	-4	0	0

a. Less than $500,000.
Note: Components may not sum to totals because of rounding.

The mandatory costs of this legislation would fall within budget functions 600 (income security) and 950 (undistributed offsetting receipts). This estimate assumes that S. 2420 will be enacted by October 1, 2000.

BASIS OF ESTIMATE

Title I: Long-Term Care Security Act

S. 2420 specifies that eligible individuals who opt to purchase long-term care insurance would be responsible for 100 percent of the cost of the premiums, so that the federal government would not incur net costs over the long term. However, because OPM would expend funds for start-up and administrative expenses before enrollees' premiums are received, the agency would incur outlays in 2001 and 2002, which would be direct spending from the Employees' Life Insurance Fund.

Upon enactment, OPM would be allowed 18 months to set up the long-term care insurance program. CBO assumes that, if the bill were enacted in fiscal year 2000, OPM would begin in 2001 to negotiate with one or more insurance carriers to establish the benefits to be provided under the plan and the premiums to be charged. Marketing the chosen plan or plans would begin in 2002. The program would take effect in 2003, and premiums would begin to be deducted from enrollees' salary or retirement payments. The federal government would not contribute to the enrollees' premiums, and the insurer or insurers would be required to reimburse OPM for the agency's expenses in setting up and administering the plan.

The expenses that OPM would incur before being able to collect premiums from enrollees and reimbursement from the insurers would be paid from the Employees' Life Insurance Fund. Based on information from OPM and the costs of administering other benefit programs, CBO estimates that start-up costs over three fiscal years would be about $23 million. A significant portion of the costs would be for education and outreach—especially for printing and mailing brochures to inform potential participants of their eligibility and options under the plan. About 10 percent of the estimated costs represents expenses for drafting specifications for the plan, evaluating contract proposals, negotiating with contractors, and setting up systems for tracking enrollment and premium deductions.

Expenditures for education and outreach would be significant because long-term care insurance is a new benefit for many employees, unlike pensions and health insurance, which are already established and familiar. Furthermore, OPM would have to contact active and retired military personnel, whose benefits are ordinarily administered by the Department of Defense. Intensive outreach efforts can help attract a larger pool of participants, which would help to assure the plan's financial solvency by broadening the distribution of people who pay premiums and including more enrollees with a low risk of needing services.

Expenses of $3 million in 2001 would be primarily for developing the long-term care insurance plan and negotiating with insurers, while education and outreach expenses are projected to increase outlays to $18 million in 2002. Start-up expenses for administrative costs and processing enrollment in the first year of the plan's operation are estimated to amount to $2 million in 2003. Once the insurance program is established, CBO expects that, beginning in 2003, OPM would incur costs of about $1 million annually to administer it. Reimbursement of the estimated $23 million in start-up costs incurred from 2001 through 2003, as well as for the first-year administrative expenses of $1 million, would occur in 2003, so that receipts would exceed outlays by OPM by about $21 million in 2003.

Those ongoing expenses are expected to remain steady unless another open season is held. The bill directs OPM to conduct open enrollment seasons periodically, during which administrative expenses would be expected to increase. However, frequent open seasons would create greater opportunities for risk selection, as low-risk individuals could defer joining the plan until they perceive that their risk of needing long-term care has changed. The bill would make it harder for people to elect coverage only when their risk changes by authorizing the insurance plans to apply underwriting standards for individuals who defer joining at their first opportunity. Nevertheless, CBO expects that OPM would allow open seasons infrequently. If open seasons occur at the same intervals as the length of the contract specified in the bill, or once every seven years, the next increase in outlays for a new open season would occur in 2010.

S. 2420 specifies that the government collect premiums from most enrollees by withholding a portion of their pay and, in turn, transfer those amounts to the insurance companies. These transactions would also be direct spending but would have no significant net effect on the budget.

Title II: Federal Erroneous Retirement Coverage Corrections Act

There are two main retirement programs for full-time regular federal employees. Most full-time employees hired before 1984 are in the Civil Service Retirement System, a defined benefit plan. Those hired after 1983 are generally covered by the Federal Employees' Retirement System, which features a more limited defined benefit than CSRS and the defined contribution Thrift Savings Plan with matching contributions by the government. Employees in CSRS are not covered by Social Security, while those in FERS are. Employees who return to government service after 1987 and have five years of prior service under CSRS may be covered by a hybrid plan known as CSRS Offset, which features a combination of CSRS and Social Security benefits.

FERS employees may contribute up to 10 percent of their pay to the TSP. They receive an automatic contribution from their employing agency equal to 1 percent of their pay and may also receive an additional 4 percent in matching contributions. CSRS and CSRS Offset employees may also participate in the TSP, but they may only contribute up to 5 percent of their pay and do not receive any government contributions.

Assumptions about Retirement Coverage Errors. CBO estimated the number of retirement coverage errors that have been made based on discussions with personnel officials in a number of large government agencies, including the Postal Service and the Departments of Defense, Veterans Affairs, and Agriculture. Those agencies comprise approximately 70 percent of the federal civilian workforce. On the basis of those discussions, CBO estimates that approximately 18,000 coverage errors have occurred throughout the government, of which approximately 12,000 have already been corrected. The two most common types of coverage errors appear to involve employees who should be in FERS but were accidentally put in CSRS and employees with prior service who returned to government service and were misplaced in either FERS or CSRS Offset.

Under current law, coverage errors are usually corrected by converting the employee to the proper retirement system, retroactive to the original date of the error. However, some employees who were accidentally placed in FERS may remain in FERS by making a retroactive election of FERS coverage.

S. 2420 would allow most employees affected by coverage errors to choose whether they would like to be placed in the proper retirement system or make their incorrect coverage permanent. Employees who have been incorrectly covered by CSRS could elect only CSRS Offset or FERS. Employees whose coverage errors have not been corrected would have 180 days after the discovery of the error to make an election; employees whose coverage errors have already been fixed would have 18 months after the issuance of final implementing regulations to make their election. All elections would be irrevocable, and employees who did not make an election would remain in their current coverage. Coverage errors lasting less than three years would not be covered by the bill. CBO assumed that under the bill agencies would stop correcting coverage errors for the first six months of 2001 pending the issuance of final regulations to implement the bill, and that they would finish processing the resulting backlog by the end of 2002.

Under current law, when an individual's coverage is corrected to FERS, the employing agency makes a lump-sum deposit into his or her TSP account based on the employee’s prior TSP contributions. That deposit is equal to the contributions the government would have made and earnings that they would have generated under FERS rules. If the employee did not have a TSP account, only a deposit for the automatic 1-percent contributions is made. Earnings are calculated using the individual's own fund allocation decisions (if he or she had a TSP account) or the G Fund rate (otherwise). Employees may provide makeup contributions to their TSP accounts out of future pay. These makeup contributions receive agency matching contributions (up to the 5-percent FERS maximum) and related earnings as if the contributions had been made at the proper time. However, back earnings are paid only on the agency's matching funds, not on the employee's makeup contributions.

For employees who elect FERS coverage, the bill would require agencies to pay lost earnings on the employees' makeup contributions to the TSP. (Employees whose coverage had been corrected to FERS before the bill's enactment would receive makeup earnings on any makeup contributions made prior to enactment.)

CBO assumed that these employees' choice of retirement coverage would be strongly influenced by whether or not they had made significant contributions to the TSP while they were incorrectly covered by CSRS or CSRS Offset. Most employees with little or no prior TSP contributions would need to make retroactive contributions for a substantial amount of time—as much as eight or nine years—in order to make up the contributions they would have made under FERS. For these employees, CSRS Offset coverage would be relatively attractive. In contrast, employees with significant prior TSP contributions might need only two to three years to catch up. As a result, many of these employees would still choose to have their coverage corrected to FERS.

Most employees covered by CSRS have not made regular contributions to the TSP. According to the Federal Retirement Thrift Investment Board, only 22 percent of CSRS employees made contributions to the TSP in 1989 (the earliest year of data available). This percentage has since risen but did not exceed 50 percent until 1996. CBO estimates that only a third of employees erroneously placed in CSRS or CSRS Offset have made significant contributions to the TSP, and assumed that 80 percent of those employees would elect FERS coverage. Two-thirds of the employees incorrectly placed in CSRS or CSRS Offset have made little or no TSP contributions, and CBO assumed that 80 percent of those employees would elect CSRS Offset coverage. Overall, we assumed that 60 percent of those employees would elect CSRS Offset coverage and 40 percent would elect FERS.

Effects on Discretionary Spending. CBO estimates that discretionary spending would decline by $51 million over the 2001-2005 period as the result of S. 2420.

Makeup Contributions to the TSP. S. 2420 would have two effects on the makeup contributions that agencies pay to the TSP. Agencies would not have to pay makeup contributions for employees who elect CSRS Offset coverage instead of FERS, but payments for individuals who elect FERS coverage would be higher than under current law. This latter effect would predominate in 2002, when agencies would pay for lost earnings on the makeup contributions made by employees whose coverage errors were corrected before the bill's enactment. In later years, annual agency spending on makeup contributions would decline because many employees would elect CSRS Offset coverage and not be eligible for makeup TSP contributions. CBO estimates that overall agency spending on makeup TSP contributions would increase by $4 million over the 2001-2005 period.

Makeup Payments to Social Security. Agencies are currently responsible for paying makeup Social Security payroll taxes covering the last 3 years, 3 months, and 15 days for employees whose coverage is changed from CSRS to FERS or CSRS Offset. Since agencies would stop correcting coverage errors in the first six months of 2001 (and thus make fewer corrections than under current law), CBO estimates that makeup payments would decrease slightly in that year. However, makeup payments would be slightly higher in 2002 as agencies work through the backlog of uncorrected errors. CBO estimates that these amounts would be less than $500,000 in each year.

Makeup Payments to the CSRDF. Under current law, adjustments to past agency contributions to the CSRDF are completely retroactive. Agencies contribute 8.51 percent of basic pay for most employees covered by CSRS or CSRS Offset and 10.7 percent of basic pay for most employees under FERS. Agencies thus make additional contributions for employees whose coverage is changed from CSRS or CSRS Offset to FERS and receive a partial refund of their retirement contributions for employees whose coverage is changed from FERS to CSRS or CSRS Offset. This bill would have similar requirements, except that agencies could no longer receive partial refunds of their contributions. Since many employees who would be switched to FERS coverage under current law would elect CSRS Offset coverage under the bill, the payments that agencies make for retroactive adjustments would decrease by $12 million over the 2001-2005 period.

Agency Retirement Contributions. The amount that agencies contribute toward their employees' retirement would decline by $19 million over the 2001-2005 period as more employees are covered by CSRS Offset rather than FERS compared to current law.

Employer TSP Contributions. The employees who elect CSRS Offset coverage under S. 2420 would no longer be eligible for the automatic and matching TSP contributions available under FERS, lowering agency spending on TSP contributions by $27 million over the 2001-2005 period.

Employer Social Security Contributions. Agency payments of Social Security payroll taxes would decline by negligible amounts in 2001 and 2002, due primarily to timing differences in the number of coverage errors corrected.

Effects on Direct Spending. Direct spending would be affected in a variety of ways by the retirement correction provisions.

OPM Administrative Expenses. S. 2420 would allow OPM to pay the costs of implementing title II directly from the CSRDF. CBO anticipates that OPM would incur most of these costs in 2001 and 2002, when it would issue implementing regulations and process elections made by employees with coverage errors that were corrected prior to the bill's enactment. CBO estimates that these administrative costs would total about $1 million in both 2001 and 2002, and about $100,000 annually after that.

Federal Retirement Benefits. Since the employees affected by retirement coverage errors are generally still in the middle of their careers, CBO anticipates that S. 2420 would not have a significant impact on federal retirement benefits over the 2001-2005 period. However, a small number of disabled retirees and survivors would be eligible to make an election under the bill, and CBO assumes that some of them would receive higher benefits by changing their retirement coverage. (Individuals who change their retirement coverage would also receive retroactive benefits.) CBO estimates that annual spending on retirement benefits would rise by negligible amounts over the 2001-2005 period, except in 2002, when most elections would be processed and outlays, mostly for retroactive benefits, would rise by $2 million.

Transfers from the CSRDF to Social Security. Employees who have been mistakenly covered by CSRS when they should have been in CSRS Offset or FERS have been contributing 7 percent of their basic pay to the CSRDF, instead of contributing 0.8 percent to the CSRDF and 6.2 percent to Social Security. When the coverage error is corrected under current law, the 6.2 percent in erroneous CSRS contributions (up to the Social Security taxable maximum) is generally transferred to the Social Security trust funds. S. 2420 would continue this practice, but transfers from the CSRDF to Social Security would decrease by $3 million in 2001 and rise by $3 million in 2002 due to timing effects.

Postal Service Contributions to the CSRDF. As noted earlier, agencies would make lower contributions to the CSRDF under S. 2420 because many affected employees would change their retirement coverage from FERS to CSRS Offset. CBO estimates that this would reduce offsetting receipts to the CSRDF by $15 million over the 2001-2005 period. (CBO's estimate includes only the change in contributions for the Postal Service; effects on contributions from other agencies are not scored because they depend on the future level of appropriations.)

Postal Service Outlays. CBO estimates that S. 2420 would increase outlays for the Postal Service by a total of $4 million in 2001 and 2002 and by larger amounts in subsequent years. CBO assumes that the Postal Service would offset these higher costs in 2003 by raising postage rates.

Postal Service Contributions to Social Security. Postal Service contributions to the Social Security trust funds would be slightly lower in 2001 and slightly higher in 2002 due to the effects that S. 2420 would have on when coverage errors are corrected. The amounts involved would be less than $500,000 each year.

Receipt of Transfers by Social Security. The timing shift in payments from the CSRDF to Social Security would reduce offsetting receipts to the Social Security trust funds, which are off-budget, by $3 million in 2001 and increase receipts by $3 million in 2002.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the on-budget effects in the current year, the budget year, and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in outlays	3	23	-16	5	5	6	6	7	7	8
Changes in receipts	not applicable									

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 2420 would preempt state and local laws that govern long-term care coverage and benefits if those laws conflict with benefit contracts for federal employees. While this preemption would be an intergovernmental mandate, state and local governments would not bear any additional costs because the preemption would limit the scope of regulation by those governments.

The bill also would change the way the government of the District of Columbia and Gallaudet University correct errors associated with the incorrect enrollment of employees in federal retirement plans. This requirement would be both an intergovernmental and private-sector mandate as defined by UMRA. However, costs associated with making those corrections would be minimal because only a small number of employees have been affected by errors addressed by the bill. Consequently, CBO estimates that the total cost of the mandate would be minimal and would not exceed the thresholds established in UMRA.

PREVIOUS CBO ESTIMATES

In March 2000, the House Committee on Government Reform ordered reported H.R. 4040, which would also establish a long-term care insurance benefit for federal employees. CBO estimated that OPM's outlays for establishing and administering the new benefit would be the same under H.R. 4040 and S. 2420. The estimates for the two bills differ in one regard. The estimate for H.R. 4040 assumed that insurers would be allowed to spread their reimbursement of administrative and start-up expenses over the duration of the seven-year contract, while S. 2420 specifies that reimbursement for incurred expenses be paid during the first year.

On August 24, 1999, CBO estimated that S. 1232, the Federal Erroneous Retirement Coverage Corrections Act, as ordered reported by the Senate Committee on Governmental Affairs on August 3, 1999, would decrease discretionary spending by $42 million and increase direct spending by $42 million over the 2000-2004 period. The provisions of S. 1232 are very similar to those of title II of S. 2420, and CBO prepared its estimates for the two bills using the same basic assumptions.

The difference between the direct spending effects of the two bills primarily reflects a change in CBO's scoring methodology. In its estimate of S. 1232, CBO included the bill's effect on the offsetting receipts received by the CSRDF. Since issuing that estimate, CBO has consulted with the Budget Committees and changed its scoring approach. Because agency payments to the CSRDF come mostly from appropriated funds and are purely intragovernmental, including their effect on offsetting receipts can present an inaccurate picture of a provision's impact on mandatory spending. As a result, CBO no longer scores the effects that higher (or lower) agency payments to the CSRDF have on offsetting receipts, unless those payments come from funds that have already been appropriated or are being appropriated in the same piece of legislation. This new scoring approach does not affect payments made by the Postal Service, which is largely funded outside of the appropriations process.

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